



# 2026 Leveraged Finance Outlook: The New 90/10 Rule

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## Executive Summary:

- We believe a new “90/10 rule” will be key to navigating leveraged finance markets in 2026: namely, seeking the best of the roughly 90% of issuers that are generally stable and performing well, while avoiding the riskiest 10% — primarily highly leveraged credits that may be subject to complex restructurings or legal complications, such as liability management exercises (LMEs).
- Against a backdrop of moderating growth and broadly stable credit fundamentals, we’ll be watching the impact of AI, including a pivot in Big Tech toward debt financing of AI buildouts. This trend could have diverging effects, bringing opportunities in the high yield bond segment and disruptions among some leveraged loan issuers.
- We view both bonds and loans as fairly valued and believe collateralized loan obligation (CLO) tranches continue to offer relatively attractive total return potential, which argues for a balanced and diversified investment approach.
- The key to performance in 2026 will be finding the best opportunities among the healthy majority of issuers through robust credit research and risk management, while largely avoiding the distressed minority.

Against a backdrop of moderating growth and broadly stable credit fundamentals, a new “90/10 rule” is emerging in the leveraged finance markets in 2026. Essentially, we see a distinct split between the roughly 90% of issuers that are stable, performing well and may have a place in investors’ portfolios — and the remaining 10% — primarily highly leveraged credits that may be subject to complex restructurings and legal complications, such as LMEs, which are best avoided at prices anywhere near par.

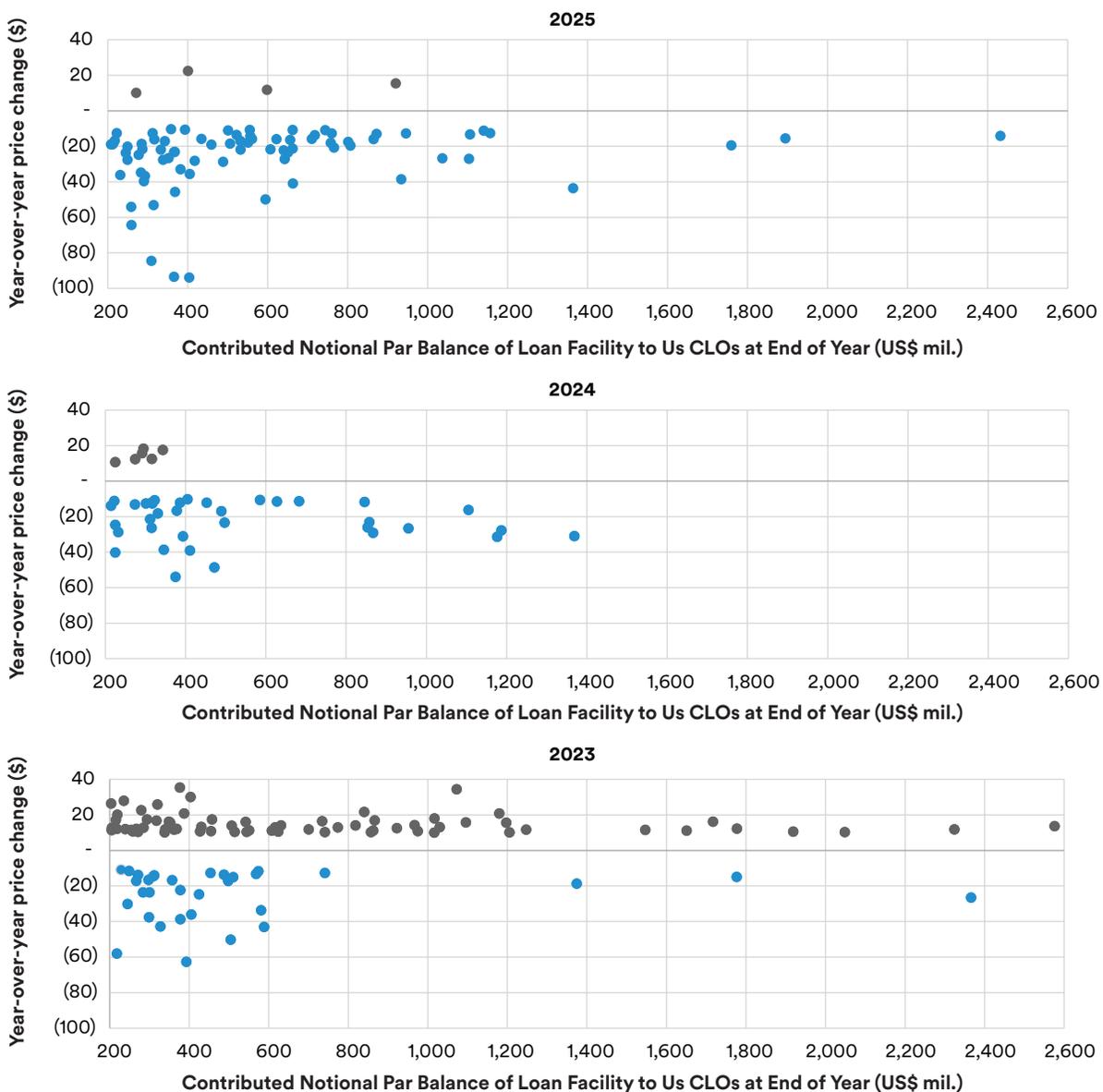
In the top 90%, we continue to find attractive opportunities in both the bank loan and high yield markets, despite our view that both are fairly valued overall. In CLOs, the technical picture remains supportive and we find return potential relatively attractive, though tight valuations may argue for a marginally more defensive stance.

The lower 10% of assets has been demonstrably problematic for the past couple of years, with poor recovery prospects, significant downside risk, and a strong tendency to drag down overall portfolio performance. The emergence of liability management as a mainline tool, primarily utilized by aggressive issuers and their private equity sponsors, has complicated the reality for creditors in this segment of the market. Price declines due to industry news or an earnings miss for an overleveraged issuer now lead to LME fears, causing many market participants to simply abandon the issuer.

In the loan market, for instance, as the first set of charts below demonstrate, the more volatile loans in the market were more likely to see prices drop than rise in the past two years, a reversal of the dynamic in 2023; and once prices fall, they are far less likely to recover. This has led to an increased bifurcation between performing and distressed loans, as shown in the line chart further below.

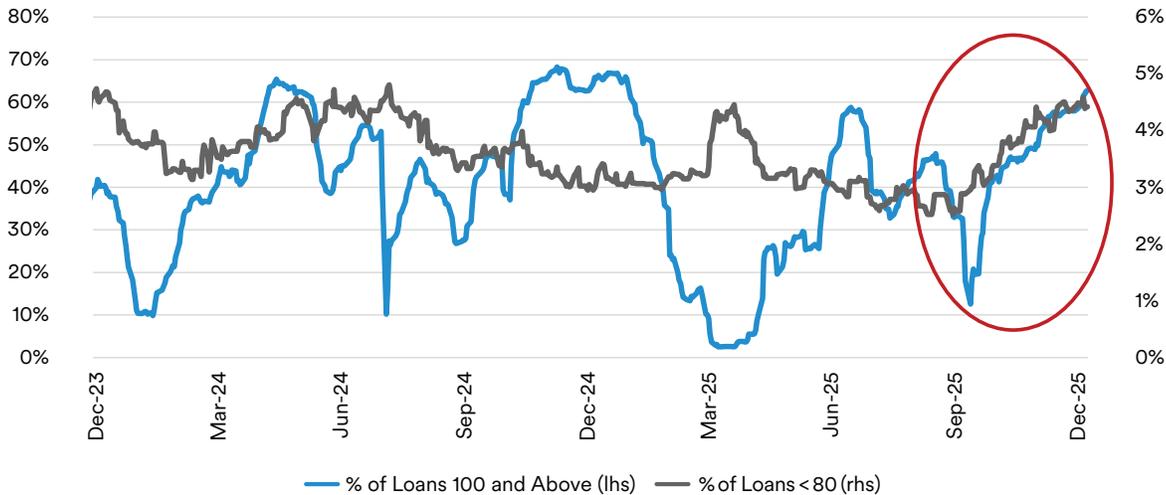
This dynamic can make tail risk more challenging to manage and reinforces the importance of careful credit selection for all leveraged finance asset classes. Buying at a discount, with the hope that the upside potential would pan out, has often not turned out well.

**Figure 1 | Loans With Price Changes of More Than 10 Percentage Points**



Source: Intex, Markit, Moraan Stanlev CLO Tradina Desk as of 5 January 2026.

**Figure 2 | The Loan Market Has Grown Increasingly Bifurcated**



Source: PitchBook | LCD, US Leveraged Loan Index Daily Spreads, as of 9 January 2026.

In the current tight spread environment, the key to performance in 2026 will be in successfully discerning opportunities among issuers in the top 90-ish percent through careful credit selection while avoiding the stressed minority when priced only to offer incremental yield pickup.

## The Macro Backdrop: Moderating Growth and Stable Fundamentals Meet AI Disruption

Leveraged finance investing this year is framed by a macro environment of moderating economic growth on a base of strong credit fundamentals, with no signs of an imminent blowup in the credit cycle. The most recent earnings season has also been positive overall for issuers, though dispersion at the sector level has been sharp. Energy and retail companies, for instance, have beaten low expectations, with more companies raising than lowering guidance, while the chemicals sector is facing headwinds from weak global demand and significant overcapacity.

A key factor we continue to watch is the influence of artificial intelligence (AI) on companies — particularly how AI is driving capital expenditures in some sectors, such as independent power producers and telecoms — along with the impact of a pivot in Big Tech funding of AI buildouts toward debt financing and away from a traditional reliance on internal cash flows.

The leveraged finance universe tends to include later-stage companies for which AI may be more of a competitive threat than a benefit, though its impact differs among asset classes. In high yield, AI has driven financing needs, particularly in data centers and technology infrastructure, creating opportunities. In loans, on the other hand, AI has served as more of a disruptor to existing businesses, posing long-term threats rather than immediate financing opportunities.

## High Yield Bonds: Sticking With The ‘Sweet Spot’

Overall, we expect positive, carry-based total returns for high yield bonds in 2026 (but muted excess returns) and believe investors are generally being compensated adequately for credit risk amid moderate default expectations, with valuations fair overall.

In line with our broader “90/10” view, we regard the BB and B rated segments as the “sweet spot” for high yield investors and are narrowing exposure to lower-quality debt. We believe default risk remains low in aggregate and is concentrated in select companies and industries facing secular or structural pressures.

We are becoming more cautious on issuers tied to lower-income consumers, which may experience more pressure in the current K-shaped economy.

The high yield market currently has a higher proportion of BB rated credits than it has historically, which influences spread levels. The triple-C segment, historically a source of excess returns, has underperformed in recent years, reflecting structural changes and legal challenges among some distressed credits. Moreover, CCC issuance accounted for just 3% of 2025 supply, the lowest share in more than two decades.<sup>1</sup> While we expect the broader market to remain stable, with potential for spread tightening in the higher-quality segments, the lower-rated credits remain a concern.

High yield continues to offer attractive risk-adjusted yields relative to equities, where price/earnings ratios remain elevated, volatility is likely to persist, and earnings growth and capital expenditures are concentrated in a small cohort of companies.

We believe that while high yield bond valuations are fair overall, selective opportunities will continue to arise for active investors in 2026.

## Leveraged Loans May Stage a Rebound After Underperforming in 2025

While loans underperformed other fixed-income assets in 2025 due to the lack of yield curve benefit, our expectation is that loans could be among the top fixed-income assets once again in 2026.

Economic conditions should continue to support loan issuer fundamentals in the coming months, as markets digest inflation and labor market data. However, we expect persistent episodes of volatility that skew toward issuers with weaker credit profiles or those feeling pressure from AI disruption, along with sectors facing broader economic headwinds, such as autos and chemicals.

The start of the year has also highlighted renewed headline risk related to government policy, with signs that the Trump administration may target certain sectors via the bully pulpit — including healthcare and financials — to signal efforts to address affordability ahead of the midterm elections. If so, we could see some issuers from these sectors shift into the lower 10% of underperforming credits.

That being said, healthy fundamentals and limited maturities over the next two years should limit distress within the broader loan market. Indeed, measures of distressed activity, including payment defaults and LMEs, trended lower through the fourth quarter of 2025. However, the percentage of the loan market trading below 80, a common measure of distress, increased during the same period, which suggests this trend may flatline. While loan portfolios have seen some spread tightening, this has been largely repricing-driven and is a result of strong loan technicals, in addition to good credit performance.

The market anticipates increased issuance driven by mergers and acquisitions this year, which may act as a catalyst for some spread widening. Overall, however, we expect a continuation of current market dynamics, barring unexpected economic developments.

In such a market, we believe that relative outperformance for loan managers, as with high yield, will be driven more by avoiding credits headed for distressed territory than by picking those that merely appear cheap. However, if loan spreads were to widen more broadly — for instance, as a result of severely negative sentiment related to the job market or consumer health — we would expect increased opportunities for alpha via credit selection.

As with other areas of leveraged finance, the key in 2026 will be in discerning the wheat from the chaff.

In European loans and high yield, third-quarter reporting has shown that issuer fundamentals remain stable as a whole, and we're starting to see improvements in interest and fixed charge coverage ratios as ECB rate cuts start filtering through. However, pockets of weakness remain across the chemicals and building materials sectors, along with some company-specific risks. Despite this idiosyncratic volatility, we expect the broader

market to tick along steadily unless macro or earnings data materially weaken. Given limited refinancing pressure, with only about €9 billion of loans coming due this year and next,<sup>2</sup> we expect default rates to remain contained overall.

## CLOs See Continued Strong Demand

We believe CLO tranches may offer attractive total return potential relative to other equivalently rated fixed income assets as we enter 2026, and the technical picture appears supportive: ETF and institutional demand are both strong, and redemption and amortization volumes remain high. Yet while risks seem balanced, tight valuations may argue for an incrementally more defensive stance.

We view the market this year as favoring CLO managers who avoid excessive concentration and rather focus on credit selection to mitigate downside risks. In current market conditions, we believe CLO refinancings and resets may be preferable to primary market transactions because their performance and management history offer a potentially better view into the risk/reward balance.

Refi/reset activity for US CLOs backed by broadly syndicated loans set an annual record in 2025, and given current spread levels, the pace looks set to continue this year. Roughly \$422 billion (notional value) of US CLOs will exit their non-call periods in 2026, \$330 billion of which are in-the-money at a 130 basis point AAA spread; this is on top of \$131 billion that are already out of the non-call period and in the money.<sup>3</sup>

In sum, we view a nimble and robust bottom-up approach to security selection as paramount in 2026 given the dispersion in the loan market, in which certain CLO portfolios holding weaker credits may eventually experience impairments to the lowest-rated debt tranches – which could result in attractive opportunities more broadly to move down the capital stack.

## Careful Credit Selection and Portfolio Management in 2026

Our outlook for leveraged finance in 2026 centers on balancing risk and opportunity in a market characterized by strong credit metrics but also structural challenges, especially in the lower-rated segments. Avoiding the riskiest credits, especially those in the triple-C category and those exposed to LME risks, has been crucial to performance in recent years and will remain paramount.

Recent geopolitical developments and renewed attacks on Fed independence did not trigger a significant immediate market reaction, but they highlight the presence of underlying risks that can quickly translate into market volatility.

While concentrated high-conviction portfolios can yield strong results in favorable years, they tend to underperform during more challenging periods. Diversification and careful selection of credits, focusing on vintage years and portfolios with lower risk profiles, will be strategically critical.

Successful leveraged finance investing increasingly depends on expert credit selection – and with our 90/10 guidance at the fore, we will take as much care in 2026 in avoiding the losers as in picking the winners.

For more insights into the trends moving markets in the coming year, see our [2026 Investment Outlook](#).

### Endnotes

<sup>1</sup> Source: Bank of America Research as of 30 November 2025.

<sup>2</sup> Source: Pitchbook as of 2 January 2026.

<sup>3</sup> J.P. Morgan, “CLO 2026 Outlook,” as of 25 November 2025.

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